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DE RUEHBR #1272/01 3021310
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FM AMEMBASSY BRASILIA
TO RUEHC/SECSTATE WASHDC 5298
INFO RUEHSO/AMCONSUL SAO PAULO 0016
RUEHRG/AMCONSUL RECIFE 0058
RUEHBU/AMEMBASSY BUENOS AIRES 6393
RUEHSG/AMEMBASSY SANTIAGO 0006
RUCPDOG/USDOC WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEHAAA/NATIONAL SECURITY COUNCIL WASHDC

UNCLAS SECTION 01 OF 04 BRASILIA 001272

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STATE FOR WHA/BSC, EEB/IFD/ODF
TREASURY FOR KAZCMAREK CKELLOGG
USDOC FOR 4332/ITA/MAC/WH/OLAC
USDOC ALSO FOR 3134/USFCS/OIO
USAID FOR LAC/AA

E.O. 12958: N/A
TAGS: [EFIN](#) [EINV](#) [ECON](#) [BR](#)
SUBJECT: BRAZIL: STAFFDEL MEECHAM - IFI/MDBs REVIEW

REF: A) BRASILIA 950

1. (SBU) SUMMARY: Officials from both the Government of Brazil (GOB) and international financial institutions (IFIs) and multilateral development banks (MDBs) operating in Brazil described for Carl Meacham, Senator Lugar's senior foreign policy advisor on Latin America, a shift from national level development lending to the sub-federal level, and a relatively well organized national policy that channels IFI/MDB lending to priority projects around the country. Major IFI/MDBs in Brazil portray their relations with the GOB as positive and collaborative, and work closely with the Ministry of Planning, Budget and Management to align development lending priorities. The Brazilian Development Bank (BNDES) has grown into a powerful development lending body in Brazil, vastly outpacing the efforts of all IFI/MDB activity in Brazil combined. A meeting with the Ministry of External Relations (MRE) and the Ministry of Finance indicates the GOB remains committed to pushing for IFI reform in the near-term, particularly within the framework of the G-20, but continues to struggle to gain the voice they believe they deserve given their successful management of the global financial crisis. END SUMMARY.

BACKGROUND

2. (SBU) In response to Senator Lugar's request that the minority staff of the Senate Foreign Relations Committee undertake a study of IFI effectiveness and financial waste prevention, Carl Meacham visited Brasilia and Sao Paulo October 19 - 21. Mr. Meacham met with representatives in Brazil from the World Bank, Inter-American Development Bank (IDB), Corporacion Andina de Fomento (CAF), International Finance Corporation (IFC), International Monetary Fund (IMF), Brazilian Development Bank (BNDES), Ministry of Exterior Relations (MRE), Ministry of Finance, and Ministry of Planning. (NOTE: approximate annual IFI lending in Brazil: World Bank, USD 5 billion; IDB, USD 3 billion; CAF, 1.8 billion; IFC, USD .5 to 1 billion. BNDES lending surpasses USD 50 billion. END NOTE).

BRAZIL'S ECONOMIC RECOVERY

3. (SBU) GOB officials and IFI bankers expressed universal optimism that Brazil has successfully managed itself out of the global financial crisis; many declaring that Brazil was one of the last of the world's major economies to be pulled into the downturn, one of the least impacted, and the first to raise itself out of the crisis. By most macro indicators, Brazil has indeed entered into a recovery position (reftel A). (NOTE: Brazil is projected to end 2009 with

near flat GDP growth, and reach four to five percent growth in 2010.
END NOTE).

IFI/MDB LENDING SHIFT TO SUB-FEDERAL LEVEL

¶4. (SBU) Mr. Meacham's meeting with Alexandre Abrantes, the World Bank's Program Manager - Portfolio and Operations, detailed a gradual shift in World Bank lending from the Brazilian federal government level to the state and municipal level. The World Bank is extending USD 4.0 billion to sub-federal governments in the current year, approximately 70 percent of their lending activity in Brazil. By contrast, only USD 300 million went to state and local governments in 2006. Abrantes attributed the shift in lending to President Lula, who, confident with growing foreign reserves, steered IFI lending away from the federal level but asked that institutions redirect efforts to the state and municipal level. IDB country representative, Jose Luis Lupo, whose bank now exclusively extends loans to the state and municipal level (approximately USD 3 billion per year), echoed the World Bank's assessment crediting Lula for encouraging the shift in the lending landscape.

¶5. (SBU) Under Secretary for International Affairs Alexandre Rosa from the Ministry of Planning, Budget and Management (who's Minister is Brazil's IDB Governor) provided additional government perspective on the shift from federal to sub-federal lending. He described a complete reversal in IFI/MDB lending from six years ago when almost all lending was directed to the federal level, to the current environment where almost all lending, approximately 90 percent, is conducted at the state and municipal level. Rosa explained that this shift coincided with the federal government's fiscal adjustment

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period which produced primary budget surpluses (government revenue collections minus spending before interest payments) and growing international reserves. He added that the federal government maintains isolated small scale lending activities with the IFI/MDBs but that these projects are intended to transfer technical expertise and bolster long-term relationships with the IFI/MDBs as opposed to supplement federal budgets.

POSITIVE RELATIONSHIP BETWEEN IFI/MDBs AND GOB

¶6. (SBU) In their separate meetings, the World Bank's Abrantes and IDB's Lupo agreed that relations between the IFI/MDBs in Brazil and the GOB are strong. Abrantes commented that, "Brazil knows what it wants, is efficient compared to other countries, and has no political hang-ups." Lupo expressed a similar sentiment, saying, "Brazil respects institutionality and the rule of law, and has not gone down the path of threatening private ownership and wrecking the economy." Both development bankers also cited collaborative working conditions with the GOB, specifically with the Ministry of Planning; a sentiment that was also expressed by the CAF representative in Brazil, Moira Paz-Estenssoro. Abrantes commended the World Bank Country Partnership Strategy, a process that occurs every four years, timed to coincide just after the country's presidential elections, to coordinate development lending priorities between the IFIs and the Ministry of Planning. More frequent communications occur through the Ministry of Planning's COFIEX (External Financing Commission), which coordinates ongoing IFI/MDB lending and project oversight within Brazil's public sector.

¶7. (SBU) In the meeting with the Ministry of Planning, Under Secretary Rosa also provided additional details on the IFI/MDB landscape in Brazil. Rosa explained that every state in the country and many of the large municipalities have direct relationships with the IFI/MDBs. Rosa's role within the Ministry of planning is to coordinate these relationships and track the amount of lending and project types through mechanisms like the Country Partnership Strategy and COFIEX. Rosa described a positive and collaborative relationship between the GOB and IFI/MDBs, but admitted that there was a period of confusion as the Ministry of Planning adjusted for the shift in development lending from the federal level to the local level approximately six years ago.

18. (SBU) IFC Country Manager Andrew Gunther and Investment Officer, Daniel Susa reported to Meacham in Sao Paulo that the IFC plays a niche role in Brazilian project finance (between USD 500 million and USD 1 billion per year), noting their comparatively small presence in the country next to heavyweight BNDES (NOTE: both BNDES and IFC focus on private sector. END NOTE). Nevertheless, Gunther emphasized that IFC loans are an attractive option for medium-sized companies looking to access international credit for the first time and raise their loan profile. IFC focuses on targeting profitable projects with maximum development impact, concentrating on three main loan programs: low-income families for educational purposes and microfinance; promoting competitiveness; and climate change and renewable energy. Gunther said IFC has only limited engagement with the Brazilian public sector, but does coordinate with the World Bank on some projects at the sub-national government level and in defining strategic priorities.

IMF SAYS BRAZIL IS GAINING STATURE

19. (SBU) In a meeting with the IMF in Brazil, Resident Representative Paulo Medas said that the Brazil-IMF relationship underwent a dramatic improvement since Brazil paid off its final tranche of IMF loans in 2005, and that the IMF is encouraging Brazil to take on greater participation in IMF policy. Medas described an evolution in the relationship between Brazil and the IMF, developing from a situation where Brazil felt mistreated to one where Brazil feels comfortable playing a leadership role within the IMF, especially through the G-20. On G-20 and IMF coordination, he said, "in the last two G-20 meetings, Brazil has really gotten a sense of how to work through the G-20, and has learned how to cooperate, negotiate, and compromise." According to Medas, Brazil sees the G-20 as their best way to effect change within the IMF, including on

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their high priority goal of gaining greater representation for emerging economies. He added that while the United States has been supportive of a quota shift from developed to emerging nations, Europe, especially the smaller European countries, has been less enthusiastic to give up representation.

110. (SBU) Despite improving relations, Medas said Brazil still exhibits an "anti-Fund" mentality from time to time, has not fully embraced the G-20 negotiation process and, further, cautions Brazil to be more sensitive to regional concerns. Brazil, according to Medas, remains resistant to IMF technical assistance and instruction, but added that Brazilian ministries have recently showed signs of technical engagement, making specific requests for IMF visits and expertise. Prior to the last two G-20 meetings, Medas said Brazil routinely derailed emerging market consensus, but contends Brazil has matured into a more constructive partner. He added, however, that Brazil must still fully adopt the G-20 negotiation process and said their continued reluctance in this area continues to draw international criticism, including from French Finance Minister Christine Lagarde, who Medas said delivered the message during a recent visit to Brasilia last month. Medas also said that Brazil's growing international clout has prompted countries in the region to complain that Brazil is "more forceful than the U.S."

MRE AND MINISTRY OF FINANCE, BIAS FOR ACTION AND REFORM

111. (SBU) In a joint meeting with the Ministry of External Relations (MRE) and the Ministry of Finance, MRE's head for international financial policy Luis Balduino raised GOB's interest in IFI reforms, and expressed that Brazil's current political situation is very conducive for near-term progress on IMF reform. He reiterated that Brazil wants to see a reformed IMF that is more flexible and agile, and more responsive to the needs of the developing world. He commented that there is much less debate in Brazil than in the United States with respect to supporting IFIs. As an example, he said that when Brazil committed the USD 10 billion

to the IMF, the move was almost universally accepted in Brazil, even within the opposition political parties. Balduino suggested that the political environment in the country was supportive of Brazil encouraging IMF reform within the next two years, but also added that the United States "should not be too pushy" in asking for additional contributions and specific priorities as Brazil considers its role and options.

¶12. (SBU) Artur Lacerda, who monitors World Bank issues at the Ministry of Finance, said that Brazil wants to see reforms in the World Bank that strengthen its institutional capacities to address the global issues of the day: climate change, poverty reduction, and development. He added that Brazil is concerned the World Bank has strayed away from its core role as a development institution. Lacerda's colleague at the Ministry of Finance who covers the IMF portfolio, Ludmila Silva, said that Brazil is now the largest IMF donor from the developing world (NOTE: referring to Brazil's recent USD 10 billion commitment to the IMF. END NOTE.), and has shown true engagement and knowledge of the institution, yet its contributions are still not fully recognized in the IMF.

BNDES - 1,000 POUND GORILLA

¶13. (SBU) A meeting with representatives from the Brazilian Development Bank BNDES, which according to Abrantes provides more lending in Brazil than the World Bank does throughout the entire world, revealed the extent to which the federally-controlled bank dominates development lending in Brazil. According to Ilge Iglesias, Congressional Affairs Advisor to the bank's CEO, BNDES constitutionally receives 40 percent of a social security and unemployment benefit payroll tax collection (FAT) which is consolidated into the bank's operating budget and used to fund the bank's lending activities. The bank has grown significantly over the last several years, from approximately USD 19 billion worth of lending in 2003 to over USD 50 billion in 2008, to the point where proceeds from existing operations produce 50 to 60 percent of revenues, and the FAT now only comprises 3 to 4 percent. BNDES also receives funding through presidential executive decrees, which have increased significantly as President Lula directs additional funds to BNDES to fuel the government's growth acceleration infrastructure

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program (PAC).

¶14. (SBU) According to Iglesias, BNDES has undergone its own shift in operations since Lula assumed the presidency in 2003. While Lula encouraged the IFI/MDBs in Brazil to reallocate lending from the federal level to state and local governments, he transformed BNDES into a powerhouse banker for Brazil's largest development projects around the country. In contrast to IFI/MDB lending which is comparatively more focused towards public sector lending, BNDES lending, according to Ministry of Planning's Rosa, is 80 to 85 percent directed to private and state-owned enterprises. Lula also liberalized BNDES's lending operations, terminating strict lending conditions that were in place under the previous Fernando Enrique Cardoso presidency. Iglesias and Isamara Seabra, BNDES Manager of Government Relations, believed that BNDES's current focus would not change under either one of the leading presidential candidates for the 2010 elections, Dilma Rousseff or Jose Serra.

¶15. (SBU) Meetings in Brasilia produced mixed views on BNDES ambitions to undertake future development activities outside of Brazil. Iglesias and Seabra contended that BNDES did not have a serious interest in partnering with other emerging and developing market countries on development lending strategies, while Ministry of Planning's Rosa cited case examples of BNDES helping both Argentina and Peru build capacities. BNDES and Planning were both in consensus that BNDES's current primary international strategy is to assist Brazilian companies expand and export abroad. (NOTE: BNDES currently has international offices in Montevideo and London. END NOTE).

COMMENT

¶16. (SBU) Carl Meacham's meetings in Brasilia and Sao Paulo shed light on Brazil's IFI/MDB lending environment in the wake of the global financial crisis. As the IMF Resident Representative in Brazil, Medas, pointed out, Brazil's comparatively successful management of the global financial crisis has bolstered its confidence, and encouraged the GOB to be a more constructive and vocal partner within the G-20 and IMF. As Brazil continues to post impressive macro "numbers" relative to the rest of the world, and as President Lula aspires to leave his mark on the G-20 and international fora, the GOB will push especially hard for reform within institutions like the IMF and World Bank. On the other hand, Brazil's evolving interest, and past baggage, affects relations with the IMF, and the reluctance of some developed economies to fully embrace Brazil's perspectives may continue to leave Brazil feeling more on the outside rather than in their desired role as leading voice for broad IFI reform. END COMMENT.

¶17. (U) This cable was coordinated/cleared by Consulate Sao Paulo and Senate Senior Staffer Carl Meacham.

KUBISKE